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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1969

No. 572

JAMES KENDALL CLANCY,

Petitioner,

vs.

THE FIRST NATIONAL BANK
OF COLORADO SPRINGS,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Petitioner prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Tenth Circuit which affirmed the judgment of the United States

District Court in and for the District of Colorado, which reversed the findings of fact and conclusions of law of a Referee in Bankruptcy as being clearly erroneous and affirmed the Referee's findings that petitioner was "engaged in business" within the meaning of Section 14c(3) of the Bankruptcy Act.

CITATION TO OPINIONS BELOW

The Opinion of the Referee in Bankruptcy is unreported. It is appended hereto as Appendix A. The Opinion of the United States District Court for the District of Colorado is reported in 279 F. Supp. 820. It is appended hereto as Appendix B. The Opinion of the United States Court of Appeals for the Tenth Circuit affirming the District Court is reported at 408 F.2d 901 and is appended hereto as Appendix C.

JURISDICTION

The judgment of the United States Court of Appeals for the Tenth Circuit was entered on March 28, 1969. A timely filed petition for rehearing was denied without opinion on May 12, 1969. On August 12, 1969, Mr. Justice Black of this Court granted an order extending the time for filing petition for writ of certiorari up to and including September 10,

1969. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

QUESTIONS PRESENTED FOR REVIEW

1. Is one whose sole activity is speculation in the stock market "engaged in business" within the meaning of Section 14c(3) of the Bankruptcy Act?

2. Were the findings of the Referee in Bankruptcy that respondent had not relied on the financial statement clearly erroneous?

3. Did the Court of Appeals apply the "clearly erroneous" test to the findings of the Referee rather than to those of the District Court?

4. Did the Court of Appeals address itself to the question of reliance by the respondent?

STATUTE INVOLVED

The statutory provision involved is Section 14c(3) of the Bankruptcy Act, 74 Stat. 408, 11 U.S.C. § 32c(3). It is appended hereto as Appendix D along with the provision as it read prior to its amendment in 1960.

STATEMENT OF THE CASE

Petitioner filed a voluntary petition in bankruptcy on March 10, 1967, and on that date was adjudicated a bankrupt. Respondent, on September 1, 1967, filed Specifications of Objections to Discharge which came on for hearing pursuant to notice on October 18, 1967. The ground specified was that, being engaged in business, bankrupt made a materially false written financial statement, knowing it to be false, which was relied on by respondent in making a loan to bankrupt.

The referee on December 12, 1967, entered his findings of fact and conclusions of law and order finding: (1) that the financial statement was not materially false in that there was no evidence that by such false statement the bankrupt intended to deceive the bank since the inclusion of the omitted debts would not have materially changed the net worth indicated by the financial statement in relation to the amount of the loan; (2) that taking the evidence as a whole, including the short term of the note, the manner in which the loan had come about, the discussion between the bankrupt and Mr. Moon regarding the Reichhold Chemical stock and the promise to sell the stock plus the verification by the bank of the existence of such stock and its value, that the bank made the loan in reliance on the promise of the bankrupt to repay the loan out of the sale of the

Reichhold Chemical stock rather than on the statement of financial condition; (3) the referee further found that the bankrupt was engaged in a business within the meaning of Section 14c(3) of the Bankruptcy Act.

Respondent petitioned for review of the findings of the referee relating to materiality and reliance. Petitioner petitioned for review of the finding and conclusion that respondent was engaged in a business within the meaning of Section 14c(3) of the Bankruptcy Act.

The District Court by written memorandum opinion and order dated February 21, 1968, reversed the referee's findings ruling that the referee was clearly erroneous in his findings that the financial statement was not materially false and that the bank had not relied on the financial statement at least partially. The Court affirmed the referee's finding and conclusion that the bankrupt was engaged in a business within the meaning of Section 14c(3).

The court below affirmed the decision of the District Court denying the bankrupt a discharge.

The facts adduced at the hearing before the Referee are set forth fairly completely in the various opinions appended as Appendices A, B and C. Suffice it here to state that the activity ruled to be "engaged in business"

within the meaning of Section 14c(3) was speculating in the stock market by purchasing and selling stock through a brokerage house for bankrupt's own account. This activity was bankrupt's sole activity directed toward production of earned income for some time prior to the loan involved herein. The loan was for the purpose of meeting a margin call at the brokerage house.

REASONS FOR GRANTING THE WRIT

1. Section 14c(3) of the Bankruptcy Act was amended in 1960 to limit its application to those engaged in business. The Section as it read prior to its amendment and thereafter are set forth in Appendix D. Petitioner is aware of but two decisions which interpret the amendment. The first, In re Simms, 202 F. Supp. 911 (1962), decided that a share-crop farmer was not engaged in business, while the second, In re Doyle, 272 F. Supp 35 (1967) decided that a self-employed tile setter was engaged in business. Both obviously are District Court opinions. The only legislative history of the amendment available is Senate Report No. 1688, 86th Cong. 2d Sess. 1960, Vol. 2, U. S. Code Congressional and Administrative News, page 2954. The body of the report is as follows:

> "The committee believes that complete denial of a discharge is

too severe a penalty in the case of the individual noncommercial bankrupt. It is also a penalty which experience has shown to be subject to abuse. An unscrupulous lender armed with a false financial statement has a powerful weapon with which to intimidate a debtor into entering into an agreement in which the creditor agrees not to oppose the discharge in return for the debtor's agreement to pay the debt in full after discharge. The creditor may also accomplish his purpose of preserving his debt by not opposing the discharge and then suing in a State court on the ground that the debt is not dischargeable. Testimony before the Subcommittee on Bankruptcy and Reorganization by experts in bankruptcy law indicates that unscrupulous lenders have frequently condoned, or even encouraged, the issuance of statements omitting debts with the deliberate intention of obtaining a false agreement for use in the event that the borrower subsequently goes into bankruptcy.

"Even where the creditor has had no part in the issuance of a false financial statement, the exercise of his right to bar the discharge completely results in a windfall for other creditors who were not even aware of such a statement. Debts

which are dischargeable are not discharged solely because one of many debts was induced by a false financial statement. This result is not required to protect a creditor who has relied on a false financial statement since under section 17a(2) that particular debt is not dischargeable.

"In view of the protection which section 17a(2) gives to the creditor, and in view of the abuse which have grown out of section 14c(3), the committee believes that it is desirable to eliminate the false financial statement as a ground for the complete denial of a discharge insofar as the individual noncommercial bankrupt is concerned.

"The situation is somewhat different in the case of a business bankrupt. The businessman is more likely to be aware of the severe consequences to him of issuing a false financial statement. His ordinary business records enable him to produce a more accurate statement than a householder who may have a multitude of small debts and no records. Furthermore, the financial statement issued by a businessman is frequently for the purpose of establishing credit standing in the community. His creditors may never see the financial statement itself. On the other hand, the nonbusiness debtor normally issues his financial

> statement to a particular creditor as part of his application for credit or for a loan. That creditor already has the protection of non-dischargeability under section 17."

The interpretation and application of the amendment is of importance in the administration of the federal bankruptcy law. Questions will continuously arise as to whether a particular activity constitutes "engaging in business." It is desirable, in fact necessary, that this Court determine the purpose and intent of the 1960 amendment, to set guidelines and declare the tests to be applied.

In the Referee's memorandum opinion, while acknowledging that the activity of the bankrupt, if engaged in as a personal investment program by one otherwise employed would not be "engaging in business," found the bankrupt's activities, because he was not otherwise earning income and because of the time spent in the activity, was "engaging in business." The Court of Appeals applied the same test, that of it being the sole activity and giving great importance to the amount of time spent in the activity. It is believed the test applied ignores the nature of the activity. The test should be whether it is commercial and mercantile in nature rather than the amount of time spent and that the activity is directed toward the generation of income.

This Court in the case of Higgins v. Commissioner of Internal Revenue, 312 U.S. 212,

61 S. Ct. 475 (1941), affirmed a decision by the Board of Tax Appeals which held that "no amount of personal investment management would turn those activities into a business."

The petitioner in that case had extensive investments in real estate, bonds and stocks, and devoted a considerable portion of his time to the oversight of his interests and hired others to assist him in offices rented for that purpose. The Board of Tax Appeals held that his dealing with real estate constituted a business, but that his dealings in stocks and bonds did not.

This Court said at page 218 of the U. S. Reports:

> "The petitioner merely kept records and collected interest and dividends from his securities, through managerial attention for his investments. No matter how large the estate or how continuous or extended the work required may be, such facts are not sufficient as a matter of law to permit the courts to reverse the decision of the Board."

2. Settlement of the question as to whether one engaged in speculation in the stock market as his sole activity is engaging in business is plainly in the public interest. Many individuals throughout the United States are daily engaged

in purchasing and selling securities through brokerage houses for their own account. A determination that such activity is being "engaged in business" would affect the unemployed, the unemployable, retired persons, pensioned persons, those speculating in the market who may be otherwise engaged in a business, persons using family funds to so speculate in the market, and numerous others.

3. The general supervisory authority of this Court should be exercised in this matter because:

(a) The Court below erred in determining that the findings of the Referee in bankruptcy that respondent had not relied on the financial statement were clearly erroneous. A perusal of the record made before the Referee clearly supports such findings.

The Referee relied heavily upon the facts concerning the making of the loan, the testimony of the president of the bank, Moon, that he was aware that the only asset actually owned by the bankrupt was the Reichhold stock, the fact that between the time that the initial conversation took place and the financial statement form was filled out, and returned, the president of the bank verified the ownership of the Reichhold stock and its value, plus the additional fact that it was the

bank president himself who inserted on the reverse side of the financial statement the information concerning the Reichhold stock, its value and its ownership. Moon testified he relied on the financial statement. The bankrupt testified he understood the loan to have been approved upon his promise to repay the loan from the proceeds of the sale of the Reichhold stock, the financial statement being only a formal requirement of the bank to justify the loan. The Referee having heard the testimony of both, rejected Moon's testimony and adopted that of the bankrupt. Moon's acts and the chronology of event leading to the making of the loan were inconsistent with his testimony that he relied on the financial statement.

(b) The Court below, while giving lip service to the proposition that, when confronted with a situation wherein the District Court has reversed findings of a Referee as being clearly erroneous, the Appellate Court should apply the clearly erroneous test to the findings of the Referee, the Court applied the test to the findings of the District Court. This is obvious from the Court's statement that "there is substantial evidence to support the district court's finding of an intent to deceive on the part of the bankrupt

when he submitted the false financial statement." (Appendix C, p. 44)

(c) The Court below did not direct itself to the question whether the findings of the Referee that respondent had not relied on the financial statement was clearly erroneous. A brief perusal of the opinion will show that the Court did not review the record as to this question. The cornerstone of the Referee's memorandum was that the respondent did not rely on the financial statement, but relied on the promise of the bankrupt to sell a stated stock to repay the loan.

CONCLUSION

For the foregoing reasons, this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

ALAN WOODS
Counsel for Petitioner

APPENDIX A

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF COLORADO - IN BANKRUPTCY

In the Matter of	]	
	]	
JAMES KENDALL CLANCY	]	No. 67-B-976
	]	
	]	
	]	
Bankrupt.	]	

MEMORANDUM OPINION, FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER OVERRULING OBJECTIONS TO DISCHARGE INTERPOSED BY THE FIRST NATIONAL BANK OF COLORADO SPRINGS

Byron L. Akers, Jr., Haney, Howbert & Akers, attorneys for The First National Bank of Colorado Springs

Paul B. Rodden, Thomas J. Mitchell, Rodden, Cooper, Woods & Mitchell attorneys for the bankrupt

MATSCH, Referee. For a period of several months prior to February, 1967, the bankrupt

engaged in daily stock market transactions through a particular brokerage firm, buying and selling in a margin account with his securities in "street name" and relying upon this activity as his only source of earned income. In February, 1967, the bankrupt was faced with a shortage in his margin account which caused him to seek a loan of $16,000.00 from The First National Bank of Colorado Springs ("the bank"). He first discussed such a loan with a social acquaintance employed by the bank who referred him to Mr. Thomas Moon, its president. The bankrupt discussed his requirements with Mr. Moon on the morning of February 6, 1967 after which the bankrupt submitted a statement of financial condition in evidence here as First National Bank Exhibit 1. The money was advanced to Mr. Clancy in the afternoon of that day, said debt being evidenced by an unsecured note for $16,000.00 due March 8, 1967 with interest at 6-1/2 percent per annum payable at maturity on which the bankrupt is the only maker (First National Bank Exhibit 2). The note was not paid when Mr. Clancy filed his voluntary bankruptcy petition on March 10, 1967.

The bank objects to the discharge of this bankrupt pursuant to Sec. 14c(3), contending that the February 6, 1967 financial statement was materially false, that it was relied upon by the bank in making this loan which it asserts was for the bankrupt's business of securities trading. The bankrupt contends that his activities do not constitute being

engaged in business within the meaning of that section of the Act; that the bank did not rely on the statement and that it is not materially false.

The statement in question, signed by the bankrupt, indicates that it is a statement of financial condition for Mr. & Mrs. James Kendall Clancy. It shows total assets of $2,188,800.00, total liabilities of $69,000.00 and a net worth of $2,119,800.00. The schedule of assets reflects $2,000,000.00 as the value of investments in bonds and stocks. It is admitted by the bankrupt that he omitted from this statement a debt of $120,000.00 borrowed from the Central Colorado Bank of Colorado Springs on or about February 3, 1967 and a debt of $30,000.00 borrowed from the Colorado Commercial Bank in November, 1966. Thus the liabilities were understated by $150,000.00 so that the corrected net worth would be $1,969,800.00.

Both the bankrupt and Mr. Moon testified at the hearing on this objection to discharge and while their testimony is in conflict with respect to the loan transaction it is clear that the bankrupt told Mr. Moon of the purpose of this loan to meet a margin requirement; that the bankrupt advised that he would sell some securities to repay the loan within five days and that the only discussion between them respecting the ownership of any specific securities by the bankrupt was that he held 2,000 shares of Reichold Chemical stock. This information was written on the financial statement

by Mr. Moon with an indicated actual value of $32,000.00. It further appears that it was this stock that the bankrupt indicated he would sell to pay this short term loan.

It is also a fair inference from the evidence presented that the bank's officers knew that the bankrupt's wife and her family had substantial financial resources, some of which were within the custody of the bank's trust department.

Mr. Moon testified that he relied on the financial statement in approving the loan although the knowledge of the bankrupt's wife's family did come into play. Mr. Moon said that he would not have made the loan if he had been aware of the undisclosed additional bank loans of $150,000.00. He explained his failure to inquire into the other securities owned was because the bankrupt indicated his intention to sell the Reichold stock.

The bankrupt explained his failure to list the other bank loans by stating that he believed it was not material to the approval of this loan and that he understood the loan to have been approved in his meeting with Mr. Moon on the morning of February 6, the financial statement being only a formal procedural requirement of the bank. He stated that on the date of the loan his personal financial condition, exclusive of his wife's property, was one of insolvency, with debts

of $210,000.00 and assets of $80,000.00.

This situation presents three issues. Was the bankrupt engaged in business within the meaning of Section 14c(3)? Was the financial statement materially false? Did the financial statement induce the loan?

Section 14c(3) of the Bankruptcy Act states that the Court shall grant a discharge unless satisfied that the bankrupt has

> ". . . while engaged in business as a sole proprietor, partnership, or as an executive of a corporation, obtained for such business money or property on credit or as an extension or renewal of credit by making or publishing or causing to be made or published in any manner whatsoever a materially false statement in writing respecting his financial condition or the financial condition of such partnership or corporation;"

This language of limitation to bankrupts engaged in business was enacted in a 1960 amendment. The Senate Report on the amending bill indicates that it was intended to avoid the harsh result of a denial of discharge for a noncommercial bankrupt who may have been encouraged to omit creditors from a loan application by an unscrupulous lender. The report suggests that the businessman is more likely to be aware of the severe consequences

of a false financial statement; his business records better enable him to prepare accurate statements and his statements are usually issued to establish credit in the community. Senate Report No. 1688, 86th Cong. 2d Sess. 1960, Vol. 2 U. S. Code Congressional and Administrative News, page 2954.

The only case interpreting this amendment to which the parties have directed attention is In re Simms, 202 F. Supp. 911 (E. D. Va. 1962) wherein a sharecrop farmer who obtained a small loan from a consumer finance company was held not to be engaged in business. The court said at page 914:

> ". . . A fair interpretation of what Congress was attempting to do in amending section 14 and section 17 would lead to the reasonable conclusion that Congress meant to retain under section 14 sub c(3) that type of business which is mercantile in character -- one that is with regularity engaged in buying, selling and trading."

The bankrupt urges that because he was buying and selling securities for his own account he was not in business. While it may be conceded that when one who is otherwise employed purchases and sells securities in a personal investment program he does not become engaged in that business, the bankrupt's activities were not of such an incidental

character. He was engaged in the trading of securities on a full time basis and seeking his livelihood from that source. There was a direct relationship between his need for a loan and his market activity. The application of this language in Section 14c(3) must necessarily be on an ad hoc basis for it is difficult to conceive of adequate guidelines to meet the factual variants arising in bankruptcy matters. Perhaps the best standard is one of essential fairness. Thus, what Congress has said is that the knowledgeable, sophisticated and aware person, experienced in commercial credit transactions, is to be held to a higher standard of disclosure of his affairs. That higher standard applies when he obtains credit for a commercial activity. It is not unreasonable to expect that a man who is daily engaged in the sophisticated and intricate activities of trading in the securities markets should be expected to have adequate records of his affairs, to be aware of the consequences of a false financial statement and to be concerned with the standing of his credit in the community. Under the attendant facts and circumstances it must be concluded that the bankrupt was engaged in business for which the subject loan was obtained.

Conceding the debt omissions from the financial statement, the bankrupt contends that this did not make it materially false in view of the large net worth. He further contends that the bank did not rely on the

financial statement but that the loan was made upon the basis of the bankrupt's ownership of the Reichold Chemical stock.

It is clear that the words "materially false" require more than merely an incorrect statement and that the bank must have relied upon the statement in extending credit. American National Bank of Denver v. Rainguet, 323 F.2d 881, (10th Cir. 1963), Greenfield State Bank v. Copeland, 330 F.2d 767 (9th Cir. 1964) and Wylie v. Ward, 292 F.2d 590 (9th Cir. 1961). It has also been held that the statement must have been made with an intent to deceive, although such an intent may be inferred from the fact that an erroneous statement was knowingly and wilfully made to obtain credit. In re Schweizer, 271 F.2d 95 (7th Cir. 1959); In re Howat, 278 F.2d 582 (7th Cir. 1960); and Feldenstein v. Radio Distributing Company, 323 F.2d 892 (6th Cir. 1963).

The evidence in this case is clear that the bankrupt was fully aware of the existence of the debts which he did not disclose. It is difficult to believe, however, that by this omission he intended to deceive the bank for the inclusion of these debts would not in itself present a substantially different net worth in proportion to the amount of the loan. What is apparent is that the net worth was not that of the bankrupt but that of his wife. Here again there was no deception because the statement is clearly shown to be a combined

statement and the bank's officers were aware of the wife's independent wealth. The failure of Mr. Moon to make any inquiry into the bankrupt's individual ownership beyond the Reichold Chemical stock negatives a finding of actual reliance on the financial statement.

In the context of the evidence as a whole, considering the short term of the note, the discussion between Mr. Moon and the bankrupt concerning the sale of the Reichold stock and the fact that Mr. Moon by independent inquiry of the bankrupt's broker verified his ownership of this stock, it appears that the transaction was made upon the basis of the promise to repay from the proceeds of the sale of stock rather than the statement of financial condition. Whether that promise was in itself such fraud as to make the bank's debt unaffected by a discharge under Sec. 17a(2) of the Bankruptcy Act is not a matter for determination here.

It must then be concluded that the evidence does not establish the elements necessary to sustain the objection to discharge under Section 14c(3). At the time of the hearing herein the bank confessed a motion to dismiss with respect to paragraph two of its specification of objections to discharge alleging a failure to explain a deficiency in assets.

The foregoing duly considered is hereby adopted as the findings of fact and conclusions of law herein and it is

ORDERED that the specification of objections to discharge filed herein by The First National Bank of Colorado Springs is overruled and that a court reporter's fee of $17.50 payable to Theodore Zarlengo, court reporter, is taxed against said bank as costs in this proceeding pursuant to Section 2(18) of the Bankruptcy Act.

Done at Denver in said District this 19th day of December, 1967.

BY THE COURT

/s/ Richard P. Matsch
Referee in Bankruptcy

cc-Byron L. Akers, Jr., Esq.
Paul B. Rodden, Esq.
Honorable Benjamin C. Hilliard, Jr.
Honorable Robert P. Fullerton
Honorable John F. McGrath

JJ

APPENDIX B

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF COLORADO

In Bankruptcy No. 67-B-976

In the Matter of

JAMES KENDALL CLANCY,

Bankrupt.

THE FIRST NATIONAL BANK OF COLORADO SPRINGS,

Petitioner on Review,

v.

JAMES KENDALL CLANCY,

Bankrupt,

Respondent on Review.

Messrs. Haney, Howbert and Akers, Mr. Byron L. Akers, Jr., Attorneys at Law, Suite 401 Mining Exchange Building, Colorado Springs, Colorado, for Petitioner on Review.

Messrs. Rodden, Cooper, Woods and Mitchell, Mr. Paul B. Rodden and Mr. Thomas J. Mitchell, Attorneys at Law, 1441 First National Bank Building, Denver, Colorado, for Respondent on Review.

MEMORANDUM OPINION AND ORDER

DOYLE, Judge.

James Kendall Clancy filed a voluntary petition in bankruptcy on March 10, 1967. Objections to the bankrupt's discharge were filed by The First National Bank of Colorado Springs on the ground that the bankrupt had obtained a business loan from the bank by making a materially false financial statement within the terms of Section 14c(3) of the

Bankruptcy Act.[1] Referee Matsch overruled this objection in an opinion and order dated December 19, 1967. The case is before the Court on the bank's petition for review.

The facts in this case are not in substantial conflict. In its petition for review, the bank contends that the Referee drew unreasonable inferences from the facts and misapplied the law. On a review such as this the referee's inferences and findings of fact stand unless clearly erroneous. See, e.g., In re Zidoff, (7th Cir. 1962), 309 F.2d 417; and In re Knapp, (2nd Cir. 1962), 309 F.2d 479. See also, 1 Collier on Bankruptcy ¶ 14.65 (1967).

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1 Section 14c(3) of the Bankruptcy Act, [11 U.S.C.A. § 32c(3) (Supp. 1967)], provides that a complete discharge shall be granted unless the court is satisfied that the bankrupt has

> "while engaged in business as a sole proprietor, partnership, or as an executive of a corporation, obtained for such business money or property on credit or as an extension or renewal of credit by making or publishing or causing to be made or published in any manner whatsoever a materially false statement in writing respecting his financial condition or the financial condition of such partnership or corporation."

The bankrupt admits that he acquired an unsecured, short-term loan of $16,000.00 from the bank on February 6, 1967, and that in connection with this loan he submitted to the bank a financial statement showing that he and his wife had a combined net worth of $2,119,800.00, with total assets of $2,188,800.00 and total liabilities of $69,000.00. This statement failed to show outstanding liabilities in the amount of $150,000.00. The correct combined net worth was actually $1,969,800.00. The financial statement failed to disclose that most of the assets on this financial statement belonged to his wife, and that at the time of the loan he was insolvent with debts of $210,000.00 and assets of $80,000.00.

The bank contends that it would not have made the loan if the financial statement had shown the bankrupt's insolvency or the correct amount of liabilities, and that the bankrupt is therefore guilty of obtaining the loan by virtue of a false statement of credit within the meaning of Section 14c(3) of the Bankruptcy Act.

The referee overruled the bank's objection, citing a number of reasons. First, he found that the submission of a combined financial statement was not deceitful, since the statement was clearly marked "Mr. and Mrs. James Kendall Clancy." Second, that the omission of $150,000.00 in liabilities from the financial statement was not an act of deceit

by the bankrupt, since a corrected financial statement would have continued to show approximately $2,000,000.00 in net worth. Third, because the bank official involved was aware that bankrupt's wife was a wealthy woman. The referee thus found that the bank relied upon her wealth even though she did not join in signing the note. Fourth, the bank relied upon the bankrupt's promise to sell his Reichold Chemical stock and repay the loan with tne proceeds, since this promise was investigated while other sources of credit were not. Finally, the referee concluded that the bank's failure to inquire into the bankrupt's individual ownership beyond the Reichold Chemical stock demonstrated a lack of reliance on the financial statement as a whole.

The crucial findings of the referee are first, that the misrepresentation was not intentional, and secondly, that there was no reliance by the bank on the misstatement. We disagree with both of these. The overwhelming weight of the evidence requires different findings.

It strains the evidence to say that the deception was not intentional. Indeed, the referee found that "The evidence is clear that the bankrupt was fully aware of the debts which he did not disclose." Such a knowing representation is, of course, fraudulent. A.L.I. Restatement of Torts, Sec. 526. This was not, however, the full extent of the

bankrupt's wrongdoing. Implicit in the submission of the combined balance sheet was the misrepresentation that the funds of his wife were fully available to him. If he had not wished to create such an impression, why mention her assets. The truth was that the bankrupt was then substantially insolvent and it was necessary to so depict. It follows that his knowledge of the falsity stemming from the nondisclosure of substantial liabilities, when coupled with his false representation that his fortunes were substantially in the black when in truth they were hopelessly in the red, was a palpably deceptive statement, not susceptible to an inference that he acted unintentionally.

The holding of nonreliance must also be overturned. The evidence precludes an inference that the misrepresentations were lacking in materiality. True, the bank seemed eager to make the loan, but it was due to the belief that it was a safe one. No prudent banker would have released the money had he known the true facts. The testimony ~~is that~~ the bank would not have made the loan had it not been misled. To be sure, the bank did put reliance on other factors such as the showing of family wealth plus the bankrupt's promise to sell the Reichold stock and appropriate the proceeds to payment of the loan (which also turned out false). But there need not have been sole reliance on the deceit. It is sufficient if this was a substantial factor in causing the loss. See A.L.I. Restatement of Torts,

Sec. 546, and see 1 Collier on Bankruptcy, Sec. 14.39 (14th Ed., 1967). Here it was at least that. Undoubtedly, the bank did rely on the family wealth of the bankrupt's wife, but this illfounded reliance was also induced by the deception of the bankrupt that he had access to this wealth.

The referee's conclusion of nonreliance was predicated on his finding that the misrepresentation was nonintentional -- that it was at most negligent. The referee thought the bank was negligent in failing to inquire into the bankrupt's ownership of the stock. Such contributory negligence would offset a negligent representation. But where as here, the misrepresentation is knowing and intentional, negligence of the victim is not germane. The question is whether there was justifiable reliance in fact. The proposition is summed up cogently in Prosser on Torts, 3rd Ed. P. 731:

> "There have been cases in which it was said that such reliance is contributory negligence, and that the plaintiff must exercise the care of a reasonably prudent man for his own protection. Undoubtedly such language is appropriate if the defendant's misrepresentation itself is merely negligent; but when there is an intent to mislead, it is clearly inconsistent with the general rule that mere negligence of the plaintiff

> is not a defense to an intentional tort. The better reasoned cases have rejected contributory negligence as a defense applicable to intentional deceit, taking account of the effect which the representation is intended to have upon the plaintiff's mind."

The bankrupt argues that at all times relevant to this suit he was not "engaged in business" within the meaning of Section 14c(3),[2] and that the referee therefore erred in holding him subject to the requirements of that section. However, we agree with the referee's decision that the bankrupt's full-time buying and selling of securities as the sole source of his earned income constituted engaging in business under the Act. With regard to this issue, we adopt the referee's opinion which reads, in part, as follows:

> "[W]hat Congress has said is that the knowledgeable, sophisticated and aware person, experienced in commercial credit transactions, is to be held to a higher standard of disclosure of his affairs. That higher standard applies when he obtains credit for a commercial activity. It is not unreasonable to expect that a man who is daily engaged in the sophisticated and intricate activities of trading in securities should be expected to have adequate records of his affairs, to

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2 For the text of this Section, see footnote 1, supra.

> be aware of the consequences of a false financial statement and to be concerned with the standing of his credit in the community." Referee's Opinion and Order, p. 4.

* * * * *

In sum then, we hold that the referee was correct in ruling that the bankrupt was "engaged in business" within the meaning of Section 14c (3) of the Bankruptcy Act; but we hold that the referee erred 1. in finding that the bankrupt's failure to disclose $150,000.00 in outstanding debts and his submission of a combined financial statement did not constitute a materially false financial statement under the circumstances of this case; 2. in determining that this false statement of credit was not motivated by bankrupt's intent to deceive; and finally, in concluding that the false statement was not relied upon, at least in part, by the bank in making its loan to the bankrupt.

It is therefore ordered that the order of the referee be reversed; that petitioner be granted the relief sought under the specification of objections to discharge; and that the bankrupt, James Kendall Clancy, be denied a general discharge pursuant to Section 14c(3) of the Bankruptcy Act.

DATED at Denver, Colorado, this 21st day of February, A.D. 1968.

BY THE COURT:

/s/ William E. Doyle
WILLIAM E. DOYLE, Judge
United States District Court

APPENDIX C

UNITED STATES COURT OF APPEALS

TENTH CIRCUIT

MARCH 1969 - TERM

JAMES KENDALL CLANCY,]
]
Appellant,]
] No. 10038
v.]
]
THE FIRST NATIONAL BANK]
OF COLORADO SPRINGS,]
]
Appellee.]

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Thomas J. Mitchell, Paul B. Rodden and Rodden, Cooper, Woods & Mitchell, Denver, Colorado, for Appellant.

Byron L. Akers, Jr., and Haney, Howbert & Akers, Colorado Springs, Colorado, for Appellee.

Before JONES*, Senior Judge, United States Court of Claims, and BREITENSTEIN and HICKEY, Circuit Judges.

* Sitting by designation of the Chief Justice.

JONES, Senior Judge.

This is an appeal from an order of the District Court for the District of Colorado, which reversed the decree of the Referee in a bankruptcy proceeding. The Referee overruled the objections filed by the bank and granted the bankrupt a discharge. The District Judge reversed the order of the Referee and denied the bankrupt a discharge.

Appellant filed a voluntary petition in bankruptcy on March 10, 1967, and was adjudicated a bankrupt on that date. On September 1, 1967, the First National Bank (Appellee) filed specific objections to a discharge in bankruptcy. On October 18, 1967, a hearing was held before a Referee in Bankruptcy, at which hearing considerable testimony was taken. After the hearing, December 19, 1967, the Referee found that the financial statement which was submitted by the bankrupt was not materially false and that the bank could not sustain its objection because it had not relied substantially on the financial statement. The Referee further found that the bankrupt was engaged in a business within the meaning of § 14c(3) of the Bankruptcy Act.

After an oral argument on the petition for review, the district court on February 21, 1968 reversed the Referee's findings ruling that the Referee was clearly erroneous in his findings concerning the financial statement, but affirmed the Referee's finding that the bankrupt was engaged in a business within the

meaning of § 14c(3).

Appellant Clancy by his own acknowledgement, was a professional trader in the market and this was his only business activity from 1965 until bankruptcy in 1967. During this time, he had no other job and his only office was at the stockbrokers office at Boettcher and Company. He had been dealing solely in stock trading and had been engaged in transactions which involved many thousands of dollars.

On February 6, 1967, Clancy applied for an unsecured loan of $16,000.00. He had overbought his position in the stock market and needed the funds to meet a margin call on his stock trading account at Boettcher and Company. He applied for the loan at the First National Bank of Colorado Springs, the Appellee. Mr. Thomas Moon, the bank's president, requested a written financial statement since it was required in making an unsecured loan.

Clancy provided the financial statement showing that he and his wife had a combined net worth of $2,119,800.00 with total assets of $2,188,800.00 and total liabilities of $69,000.00. Though submitted as a joint financial statement of Mr. and Mrs. Clancy, it was signed only by the applicant, Clancy. While he listed $69,000.00 as the total liabilities, he, at the time of the application, was obligated to two other banks on secured

loans totaling $150,000.00; $120,000.00 at the Central Colorado Bank and $30,000.00 at the Colorado Commercial Bank, both of Colorado Springs. The Appellant did not disclose the existence of either of these loans to Banker Moon and the banker had no knowledge of them when he made the loan. In fact, only 3 days prior on February 3, 1967 to the date of the loan from appellee bank, Clancy had obtained the $120,000.00 loan from the Central Colorado Bank.

Apparently these loans in February were not enough to save Clancy from bankruptcy in March when he filed a voluntary petition in bankruptcy, only a month after he negotiated the unsecured loan.

Appellee bank objected to the general discharge of the bankrupt under § 14c(3) of the Bankruptcy Act, 11 U.S.C.A. § 32 sub. c., which reads in pertinent part as follows:

> "The Court shall grant the discharge unless satisfied that the bankrupt has * * * (3) obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing or causing to be made or published in any manner whatsoever, materially false statement * * *."

After a hearing, the Referee found that (1) the bankrupt was engaged in business

within the meaning of the Bankruptcy Act, (2) the financial statement was not materially false and that the bankrupt's misrepresentation was not intentional, and (3) there was not actual reliance upon it by the bank.

We agree with the findings of the Referee only as to number 1, and agree with the district court's rejection of findings 2 and 3.

The determination of the Referee that the bankrupt was engaged in "business" within the meaning of the Bankruptcy Act was affirmed by the district court. We believe this conclusion to be correct. The bankrupt not only spent all of his time buying and selling stock but he testified that he considered himself to be a "professional trader under the rules of the S.E.C." Every business day since December of 1965, he had been involved in stock transactions at his only office at Boettcher and Company, and these activities were his only source of income.

In 1960, the Congress amended § 14(c) to give the court the right to refuse a discharge in bankruptcy to any bankrupt making a materially false statement in writing respecting his financial condition "while engaged in business as a sole proprietor,

partnership, or as an executive or a corporation."[1]

The courts have long struggled with the term "business" and what is meant by it. It was stated in In re Green's Estate, 178 N.Y.S. 353, 360 (1919):

> "How equivocal the noun 'business' really is will readily be perceived by trite examples. * * * If I go a-fishing in this state, I am not a-doing business there; but if a fishmonger goes a-fishing to replenish his stall in this city, he is doing business within the Tax Law. It is because of the ambiguity denoted that the courts properly say that the colloquial word 'business' if used in statutes is among the most indefinite in the English language."

Though concluding that a bankrupt share-crop farmer was not engaged in "business" within the purview of amended § 14c(3),

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1 The quoted words were added for the first time in the 1960 amendment. Prior to that amendment, farmers, wage earners, retired persons, and many others were subjected to the harsh penalty of a denial of discharge as to all debts if they made a false financial statement as to a wholly noncommercial matter.

the court in In re Simms, 202 F. Supp. 911 (E.D. Va. 1962), examined the legislative history of the 1960 amendment in its effort to determine the intent of the Congress. The court states at pages 913, 914:

> "The legislative history draws a clear line of demarcation between one engaged in 'business' and one engaged in 'noncommercial activities.'***
>
> * * * *
>
> "We turn to what Congress intended by the use of the word 'business' in amending § 14 of the Bankruptcy Act. The Committee reports, as suggested, contrast 'business' activity with 'noncommercial activity.' * * * A fair interpretation of what Congress was attempting to do in amending § 14 and § 17 would lead to the reasonable conclusion that Congress meant to retain under § 14, sub. c(3) that type of business which is mercantile in character -- one that is with regularity engaged in buying, selling and trading."

Certainly, the bankrupt was engaged in business when professionally buying and selling stocks. He had no other source of income and no other job. This was his exclusive business. He also was required to keep records for all

his transactions because of the tax consequences. It is significant that in the Simms case, supra, the court uses the bankrupt who is covered by the 1960 amendment as the one "who would not be excused from keeping and preserving books of account or records under § 14, sub. c(2)." Id. at 914.

The Referee found that the financial statement was not materially false even though the bankrupt was fully aware that he had omitted over $150,000.00 liabilities to two other banks. The district court reversed such findings as clearly erroneous.

We agree with the court that the financial statement was materially false. The bankrupt submitted to the bank a misleading financial statement in order to get an unsecured short-term loan of $16,000.00 from the bank on February 6, 1967. But only 3 days prior, on February 3, the bankrupt had acquired liabilities of $150,000.00 which he failed to list. The financial statement also failed to show that most of the assets on this financial statement belonged to his wife, and actually at the time of the loan he was insolvent with debts of $210,000.00 and assets of $80,000.00.

From the bankrupt's own testimony it is clear that he was fully aware of the two secured-note obligations of $150,000.00 in liabilities, which he failed to disclose on the financial statement. Even the Referee found that "the evidence is clear that the

Bankrupt was fully aware of the debts which he did not disclose." The only explanation offered by the bankrupt to excuse these omissions is that he thought these debts were immaterial for a $16,000.00 loan, verbally okayed, that he thought in terms of the "general realm" of business assets and liabilities and that both of the omitted loans were secured. But the bankrupt also failed to disclose on his financial statement that he had pledged substantial assets as collateral in order to secure the two loans totaling $150,000.00.

Indeed, the bankrupt's own testimony is very confusing and inconsistent and varies materially as to his own assets and liabilities. On February 6, 1967, the bankrupt estimated that his liabilities approximated $210,000.00 and that his assets were $80,000.00. Yet he testified that he told Mr. Moon that the only assets he himself owned were 2,000 shares of Reichhold Chemical stock plus a "few shares of Texas Gulf Sulphur," and that all the rest belonged to his wife. In fact, he did not even own the Reichhold Chemical stock free and clear, since this stock was subject to a margin call by Boettcher and Company for which the loan was made. Only 32 days after his loan at the First National Bank had been approved, the bankrupt filed a voluntary petition in bankruptcy showing assets of only $3,654.91 and liabilities totaling $237,574.27. These numerous contradictions which appear throughout the bankrupt's own testimony can

but point to the one conclusion that he intentionally misrepresented his true financial status to the bank.

This court has held that more than an erroneous financial statement is necessary for a statement to be considered "false." It must be one that is intentionally false or one that is intended to deceive and must be relied upon. American National Bank of Denver v. Rainguet, 323 F.2d 881 (C.A. 10th Cir. 1963).

After reviewing the evidence, we find that there is substantial evidence to support the district court's finding of an intent to deceive on the part of the bankrupt when he submitted the false financial statement. From his own testimony, the bankrupt failed to disclose not only the two very large loans, but that most of his assets had already been pledged as security in these loans, and that even the stock that he claimed to own free and clear was actually pledged for a margin call.[2]

The bankrupt painted a rather sunny picture of his financial condition when actually he knew he was hopelessly insolvent. He testified he told the banker that most of the assets belonged to his wife except the Reichhold stock and a few shares of Texas Gulf

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2 The record is silent as to where the proceeds of the sale of this stock went.

Sulphur. But he made no mention of his large indebtedness that he had undertaken only 3 days prior. Nor did he tell the banker that the Reichhold stock was not free and clear. There is substantial evidence and circumstances to support the court's finding that there was material deception and that the deception was intentional. The court further found that the testimony of the banker is that the bank would not have made the loan, had it not been misled; and that he relied in substantial part at least on the financial statement. Thus, the reviewing judge was correct in finding "[i]t strains the evidence to say that the deception was not intentional."

It has been held that where a district court rejects the Referee's findings as clearly erroneous, the court of appeals applies the clearly erroneous test to the decision of the Referee rather than the district court. Potucek v. Cordeleria Lourdes, 310 F.2d 527, 530 (C.A. 10th 1962).

The Supreme Court has laid down a clear guide in testing what is "clearly erroneous" in the case of United States v. United States Gypsum Co., 333 U.S. 364, 395 (1948), by saying:

> "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction

that a mistake has been committed."

A review of the entire evidence convinces us that a mistake has been made by the Referee in his findings as to the falsity of the financial statement and the reliance upon it. The Referee was correct in his findings that the bankrupt was engaged in business with § 14c(3) of the Bankruptcy Act.

Affirmed.

APPENDIX D

Section 14c(3) of the Bankruptcy Act as it was worded prior to its amendment in 1960:

> "The court shall grant the discharge unless satisfied that the bankrupt has . . . obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing or causing to be made or published in any manner whatsoever, a materially false statement in writing respecting his financial condition; or . . ."

Section 14c(3) of the Bankruptcy Act as it now reads following amendment in 1960:

> "The court shall grant the discharge unless satisfied that the bankrupt has . . . while engaged in business as a sole proprietor, partnership, or as an executive of a corporation, obtained for such business money or property on credit or as an extension or renewal of credit by making or publishing or causing to be made or published in any manner whatsoever a materially false statement in writing respecting his financial condition or the financial condition of such partnership or corporation; or . . . ."